

OPEN MEETING AGENDA ITEM  
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

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IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY FOR AN  
EMERGENCY INTERIM RATE INCREASE AND  
FOR AN INTERIM AMENDMENT TO DECISION  
NO. 67744.

DOCKET NO. E-01345A-06-0009

**EXCEPTIONS**

The Arizona Utility Investors Association ("AUIA" or the "Association") submits these Exceptions to the Recommended Opinion and Order ("ROO") filed by Chief Administrative Law Judge Lyn Farmer on April 19, 2006. The AUIA generally supports the ROO. Judge Farmer correctly concludes that action is required now which will benefit both the company and its ratepayers.

However, the recommended relief still leaves APS dangerously close to what the Power Group refers to as the "valley of the downgraded." The penalty, among others, for falling in is \$600 million-\$1.2 billion in increased debt costs. A slight increase in relief amount and a structural change in form will reduce considerably this unnecessary risk. Thus, the Association recommends that the Commission authorize an increase of 7 mills instead of the recommended 5 mills and that it implement the relief by increasing the bandwidth of the PSA from its current 4 mills to 11 mills instead of the ROO's suggested approach of an interim adjustor.

Although they differ as to the right remedy, almost all of the parties to this proceeding recognize that two issues should be addressed to safeguard APS' credit rating: (1) the growing amount of unrecovered fuel cost IOUs and (2) the structural infirmities associated with the PSA. That is why the AUIA suggested blended approaches such as temporary relief coupled with

1 quarterly surcharges or broadening the adjustor bandwidth to 10 mills or more to make sure both  
2 concerns are met. (Closing Brief, pp. 7-9.)

3 The ROO recommends an interim or temporary adjustor for 2006 costs which does not  
4 address the second major element of PSA reform. (ROO, p. 24, ll. 16-23.) Placing to one side  
5 for a moment the issue of how large the relief should be, using instead an increase in the PSA  
6 bandwidth is a far safer way to deliver the relief—one which affirmatively addresses what has  
7 become a major PSA structural infirmity given the unprecedented increases in fuel prices since  
8 entry of last year's rate order.<sup>1</sup> It also sends this signal to the rating agencies at absolutely no  
9 cost to ratepayers and gives the Commission greater flexibility to react to market developments  
10 in the second half of this year.

11 As the Commission knows, the energy markets remain exceptionally volatile. In the few  
12 weeks since close of hearing, the price of a barrel of oil has established a new record high—  
13 about \$5.00 more than the post-Katrina record set last fall. International uncertainties, lingering  
14 production concerns and worries about the distinct possibility of another bad Gulf hurricane  
15 season, among others, virtually assure that today's market projections will be incorrect  
16 tomorrow. Indeed, Mr. Ewen testified that the revised natural gas and on-peak power estimates  
17 currently being used are conservative: "prices already have moved higher since I prepared these  
18 estimates [using February 28, 2006 prices]." (APS-14, p. 3, ll. 1-2.)

19 If the Commission uses an increase in PSA bandwidth rather than an interim adjustor, it  
20 positions itself to be able to react in a timely and orderly way next January to any of these  
21 contingencies. A bandwidth adjustment gives an assurance to the rating agencies that this PSA

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22 <sup>1</sup> As Ms. Diaz Cortez for RUCO testified: "[W]e may not have given [the PSA] all the characteristics it needed to  
23 deal effectively with such large escalating fuel prices..." (HR TR, p. 1695.) Several parties suggested support for  
24 the increased bandwidth approach. See Staff's Closing Brief, p. 10, ll. 5-13; Power Group Closing Brief, pp. 10-12;  
AUIA Closing Brief, p. 9; and APS Closing Brief, pp. 24-26.

1 flexibility exists at no additional cost to ratepayers, while preserving other elements of the clause  
2 such as the 90/10 sharing arrangement. Finally, it does not preclude further or different  
3 adjustments to PSA elements to be taken up in the general rate case.

4 Second, the AUIA recommends that the Commission authorize an increase in the  
5 bandwidth to 11 mills effective May 1, 2006—an increase of 7 mills rather than the 5-mill ROO  
6 recommendation. In the unlikely event that all projections materialize perfectly, a 5-mill  
7 adjustment will only increase the key FFO/Debt metric to approximately 17.8%. That leaves  
8 APS in non-investment grade or junk bond territory. Also, referring to APS-19A, a 5-mill  
9 adjustment still leaves APS with approximately \$185 million in unrecovered fuel costs at the end  
10 of 2006. That is \$15 million more than the fuel cost deferral level in December, 2005 when S&P  
11 downgraded.

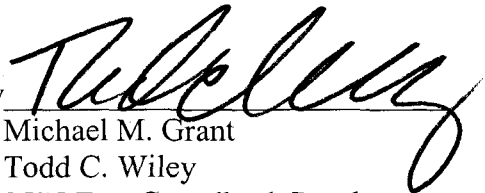
12 Although the Association believes that an even greater increase in bandwidth would be  
13 appropriate, it does appreciate the fact that the Commission must balance a variety of factors.  
14 An increase of 7 mills will (1) reduce undercollections by an additional \$40 million, (2) position  
15 the FFO/Debt metric within investment-grade territory at approximately 18.7%, (3) send a more  
16 accurate and timely price signal to customers, (4) further reduce the interest costs to be paid by  
17 ratepayers, (5) only nominally increase median/average residential customer bills above the  
18 5-mill ROO recommendation and (6) give customers, the State's economy and APS a much  
19 greater assurance that the catastrophic consequences and costs of a downgrade to junk can be  
20 avoided.

1 CONCLUSION

2 The AUIA requests the Commission approve the ROO with amendments which authorize  
3 an increase in the PSA bandwidth to and a PSA adjustor of 11 mills effective May 1, 2006.  
4 Suggested amendments to the ROO are attached as Exhibit A.

5 RESPECTFULLY SUBMITTED this 24<sup>th</sup> day of April, 2006.

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16 **Copies** delivered this 24<sup>th</sup> day of  
17 April, 2006, to each Commissioner.

18 **Copies** of the foregoing mailed  
19 this ~~24<sup>th</sup>~~ day of April, 2006, to:

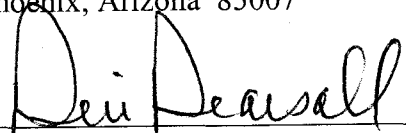
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**EXHIBIT A**

## Exhibit A

### AUIA Requested Amendments to the ROO

Delete the paragraphs starting with the paragraph at page 24, l. 14 and continuing through the paragraph concluding at page 25, l. 15 together with footnotes 11-15, renumber footnotes and insert the following:

Accordingly, in order to prevent the continued build-up of a large balance in the 2006 Tracking Account and the amount of interest that will accrue which will need to be collected from ratepayers beginning in February 2007, we will modify the PSA adjustor authorized in Decision No. 67744 to increase its bandwidth to 11 mills and, correspondingly, allow APS to change the PSA adjustor to 11 mills effective as of May 1, 2006. This increase in bandwidth and PSA adjustor change will allow APS to collect a portion of 2006 purchased power and fuel costs that are above the base cost established in Decision No. 67744. The amounts collected will remain subject to a prudence review at the appropriate time.

This adjustor change will increase the monthly median residential summer customer bill by approximately \$5.75 and the monthly average residential summer customer bill by approximately \$7.30. The monthly median residential winter customer bill would increase by approximately \$3.75 and the monthly average residential winter bill by \$4.75. Pursuant to Decision No. 67744, low-income customers on the E-3 and E-4 low-income discount rates do not pay either the adjustor rate or any surcharges.

By acting now, rather than waiting until February 2007 to begin collecting these costs, ratepayers will avoid more than \$5 million dollars in interest charges. Further, it is important to highlight that this modification to the PSA will not affect APS' earnings. It will only affect the timing of the already authorized recovery of prudent costs paid for fuel and purchased power.

At page 28, l. 28 delete footnote 16 and insert:

<sup>11</sup> Based on APS exhibit 19A, the 7-mill broadening of bandwidth and 11-mill PSA adjustor authorized here should increase the FFO/Debt ratio to approximately 18.7%, which is near the bottom of the investment grade range and we believe APS should be able to find ways to further improve that ratio.

At pages 32-33, delete Findings 36-44 and insert:

36. In order to prevent the continued build-up of a large balance in the 2006 Tracking Account and the amount of interest that will accrue which will need to be collected from ratepayers beginning in February, 2007, it is prudent to



modify the PSA adjustor to increase its bandwidth to 11 mills and allow APS to change the PSA adjustor to 11 mills effective as of May 1, 2006.

37. The revised PSA adjustor will increase the monthly median residential summer customer bill by approximately \$5.75 and the monthly average residential summer customer bill by approximately \$7.30. The monthly median residential winter customer bill would be increased by approximately \$3.75 and the monthly average residential winter bill by \$4.75.

38. Pursuant to Decision No. 67744, the PSA requires the low-income customers on the E-3 and E-4 low-income discount rates do not pay either the adjustor rate or any surcharges.

39. The increase in the PSA bandwidth and change in the PSA adjustor to 11 mills will reduce the amount of interest the ratepayers will pay by more than \$5 million and will preserve the 90/10 sharing requirement.

40. The amounts collected through the adjustor will remain subject to a prudence review at the appropriate time.

Renumber remaining Findings accordingly.

At page 35, delete Conclusion of Law 6 and insert:

6. The PSA should be modified to increase its bandwidth to 11 mills and APS should be authorized to change the PSA adjustor to 11 mills effective May 1, 2006 to collect a portion of the 2006 purchased power and fuel costs during 2006.

At page 35, l. 26, delete "interim".

At page 36, ll. 2-3, delete the Ordering Paragraph.